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**EXECUTIVE SECRETARIAT**  
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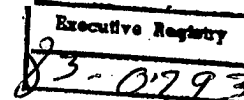
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D) Executive Secretary  
2/7/83  
Date

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THE WHITE HOUSE  
WASHINGTON



## CABINET AFFAIRS STAFFING MEMORANDUM

DATE: 2-7-83 NUMBER: 077779CA DUE BY: \_\_\_\_\_  
 SUBJECT: Cabinet Council on Economic Affairs - Wednesday, February 9, 1983  
11:00 a.m. in the Roosevelt Room

	ACTION	FYI		ACTION	FYI
ALL CABINET MEMBERS	<input type="checkbox"/>	<input type="checkbox"/>	Baker	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Vice President	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Deaver	<input type="checkbox"/>	<input type="checkbox"/>
State	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Clark	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Treasury	<input checked="" type="checkbox"/>	<input type="checkbox"/>	Darman ( <i>For WH Staffing</i> )	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Defense	<input type="checkbox"/>	<input checked="" type="checkbox"/>	Harper	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Attorney General	<input type="checkbox"/>	<input checked="" type="checkbox"/>	Jenkins	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Interior	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Agriculture	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Commerce	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
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HHS	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
HUD	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Transportation	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
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OMB	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
CIA	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
UN	<input type="checkbox"/>	<input checked="" type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
USTR	<input checked="" type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
CEA	<input checked="" type="checkbox"/>	<input type="checkbox"/>	CCCT/Gunn	<input type="checkbox"/>	<input type="checkbox"/>
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OSTP	<input type="checkbox"/>	<input type="checkbox"/>	CCFA/Boggs	<input type="checkbox"/>	<input type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>	CCHR/Carleson	<input type="checkbox"/>	<input type="checkbox"/>
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	<input type="checkbox"/>	<input type="checkbox"/>	CCNRE/Boggs	<input type="checkbox"/>	<input type="checkbox"/>

REMARKS: The Cabinet Council on Economic Affairs will meet Wednesday, February 9, 1983 at 11:00 a.m. in the Roosevelt Room. The agenda and papers are attached.

RETURN TO:

☐ Craig L. Fuller  
Assistant to the President  
for Cabinet Affairs  
456-2823

☒ Becky Norton Dunlop  
Director, Office of  
Cabinet Affairs  
456-2800

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THE WHITE HOUSE  
WASHINGTON

February 7, 1983

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER *RBP*  
SUBJECT: Agenda and Papers for the February 9 Meeting

The agenda and papers for the February 9 meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 11:00 a.m. in the Roosevelt Room.

The first agenda item is a report of the Working Group on Federal Credit Policy on the farm credit system. The executive summary of a study completed by the Department of Agriculture is attached. Copies of the entire study are available in my office on request.

The second agenda item is a continuation of the report of the National Productivity Advisory Committee. The report will review the Committee's recommendations on cooperative research and development and health care costs. The papers were circulated for the January 19 meeting. A slightly revised paper on health care costs is attached along with the paper on cooperative research and development.

Attachment

THE WHITE HOUSE  
WASHINGTON

THE CABINET COUNCIL ON ECONOMIC AFFAIRS

February 9, 1983

11:00 a.m.

Roosevelt Room

AGENDA

1. Federal Credit Policy: The Farm Credit System (CM#113)
2. Report of the National Productivity Advisory Committee (CM#255)

**A STUDY OF THE FARM CREDIT SYSTEM**

**A Report to the Secretary of Agriculture**

**Economic Research Service**

**U.S. Department of Agriculture**

**Washington, D.C. 20250**

**July 1982**

## EXECUTIVE SUMMARY

This study was conducted at the request of the Cabinet Council on Economic Affairs in response to concerns over the extent of Federal involvement in credit markets. Federal involvement in credit markets is viewed as taking five different forms:

- direct loan obligations
- loan guarantee commitments
- loan asset sales
- tax exempt securities
- sponsored credit agencies

This study is restricted to only one of these five areas: sponsored credit agencies. While the study addresses issues related to all sponsored credit agencies, primary focus is on the Farm Credit System (FCS). At issue is whether changes should be made in the operating characteristics of the Farm Credit System and if so, how such changes will affect farmers, consumers and financial markets.

Part I of this report provides background material relative to government financing and the Farm Credit System. Discussion in this section of the report reveals that:

- Direct Federal borrowing has increased over time, but in relation to total indebtedness in the economy it has declined sharply from the level of the mid 1940's. However, interest on Federal debt has increased to an estimated 2.75 percent of GNP in 1982.
- The Federal participation rate in domestic credit markets is highly variable, but was about 20 percent in 1980 and 1981.
- The gross amount of financing obtained by sponsored credit agencies has grown at an annual compound rate of 18 percent in recent years. However, the volume of new money obtained by these agencies has changed little since 1978.

- Comparison of interest rates reveals that short-term agency issuances have sold at an average 50-100 basis points lower than issuances of the corporate sector with comparable maturity. Long-term securities issued by agencies do not consistently sell at a lower rate than comparable maturity securities issued by the corporate sector. Agency securities usually trade at higher rates than comparable maturities of Federal government securities.
- Farm Credit System securities have sold at rates lower than other agency securities, suggesting that creditworthiness is an important factor in interest rates paid by agencies.
- The Farm Credit System is organized in three major parts: (1) the Federal Intermediate Credit Banks and Production Credit Associations, (2) the Federal Land Banks and Federal Land Bank Associations, and (3) the Banks for Cooperatives. The System was originally organized by the government, but all government capital has been repaid. The System operates as a borrower-owned cooperative.
- The System acquires funds for lending from two primary sources: discount notes and consolidated systemwide bonds. These securities are issued through a nationwide system of securities dealers and carry no government guarantees against default. Commercial banks are both major underwriters and purchasers of Farm Credit System securities. Other important purchasers are State and local governments, savings and loan associations, and pension funds.
- Federal Land Banks have experienced a rapid growth in market share of farm real estate debt since 1969. Market share for 1982 is estimated at 42 percent. Favorable interest rates relative to other lenders are only partially responsible for this growth in market share. Lack of available loanable funds at other institutions has also played a role in the growth of market shares.
- The market share of nonreal estate farm debt by Production Credit Associations grew rapidly from 1960 to 1975. Since 1975, however, market share has declined slightly, primarily as a result of a rapid rise in government lending by the Farmers Home Administration and the Commodity Credit Corporation.
- Farms are small in size, but have large short, intermediate and long-term credit needs. Farms must generally rely on financial intermediaries, like the Farm Credit System and others, to obtain funds for agriculture at reasonable rates and terms. Direct access to financial markets by farmers themselves is not feasible or efficient.
- There is considerable controversy over the merits of generalized versus specialized credit institutions. Federal and State regulations originated and continue to maintain the current system although market developments are eroding the system of specialized institutions. Yet there appears to be strong support and justification for some specialized credit institutions.

Part II of this report focuses on the operational differences among Farm Credit System banks and associations, and federally chartered credit unions, savings and loan associations, and national banks. Each of these lending institutions has a unique structure and regulatory environment which confers various types of competitive advantages and disadvantages. A study of operational differences reveals that:

- Farm Credit System banks and associations do not have deposit or check-writing functions while commercial banks, savings and loan associations and credit unions do have such functions. This feature allows the depository institutions access to sources of loanable funds not available to the Farm Credit System.
- Deposit insurance offered through FDIC, FSLIC, and NCUA provides explicit guarantee of deposits of up to \$100,000. However, there also appears to be a strong implicit guarantee that the Federal government will not allow FDIC, FSLIC, or NCUA to fail. This is similar in nature to an implicit guarantee that the government will not allow a default on sponsored agency's securities.
- Sources of loanable funds differ substantially for federally chartered lending institutions. These differences are a direct result of the regulatory environment under which these institutions operate. Recent changes in the regulatory environment have created a greater degree of competition for savings. These changes in regulatory environment are a result, in part, of competition from savings institutions which are not federally regulated.
- Interest paid by the Farm Credit System on bonds and discount notes is not subject to income taxes at the State or local level. Obligations of the Federal Home Loan Bank and Student Loan Marketing Association have similar exemptions. No other federally chartered lending institution examined here issues securities with this type of exemption. However, private sector corporations can benefit from the issuance of tax exempt securities issued by State and local governments.
- All federally chartered lending institutions face legal limitations on nonloan investment. However, the Farm Credit System banks and associations are limited to investments needed to facilitate temporary actions in cash and liquidity management. In contrast banks and savings and loan associations can and do invest a significant portion of their assets in nonloan investments.
- Each federally chartered lending institution has legal lending limits per customer. However, the lending limits for the Farm Credit System banks are large relative to farmers' credit needs. In contrast, low legal lending limits are a continuing problem for small rural banks. Differences in legal lending limits are based on differences in the level of capitalization and the size of the institution.

- None of the securities now commonly issued by federally chartered lending institutions requires clearance by the Securities and Exchange Commission (SEC) to be issued in the financial markets. In contrast, corporate securities over 270 days in length generally do require SEC clearance.
- Securities issued by the government or by sponsored agencies can be used as security to collateralize public deposits of the U.S. government; securities issued by national banks or private corporations are not eligible.
- Geographic limits tend to be more restrictive for commercial banks than for the Farm Credit System, credit unions, or savings and loan associations. However, large commercial banks have extended their geographic reach through consumer lending facilities, loan production offices, credit cards and other mechanisms.
- The Farm Credit System is not subject to legal limits on interest rates paid for sources of funds. Banks, credit unions, and savings and loan associations are subject to such limits under Regulation Q, but these limits are scheduled to be phased out by 1986.
- The Farm Credit System is exempt from State usury laws. Banks, S&L's, and credit unions are subject to State usury laws. However, the Monetary Control Act of 1980 permanently preempts State usury ceilings on most loans unless a State acts within 3 years to override the preemption.
- Federal Land Banks, Federal Land Bank Associations and Federal Intermediate Credit Banks are not subject to taxation except on real estate they own. PCAs and Banks for Cooperatives, commercial banks, and savings and loan associations are all taxed at corporate rates. Federal credit unions are exempt from income taxation. Provisions for losses, reserves and financial leases can reduce effective tax rates for all financial institutions subject to income taxes.
- Eligibility requirements restrict the borrowers for the Farm Credit System and credit unions. Customers of commercial banks and savings and loan associations have no comparable eligibility conditions.

Part III of this report identifies both alleged competitive advantages of the Farm Credit System and proposals to modify these alleged advantages. While this section of the report evaluates the removal of competitive advantages of FCS, it is clear from the discussion in Part II that FCS also has competitive disadvantages with other lending institutions. Advantages and disadvantages need to be weighed carefully before decisions on the need for removal of competitive advantages can be made.

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Many, but not all, of the alleged competitive advantages of the Farm Credit System relate to the fact that FCS securities are viewed as having agency status in financial markets. A variety of characteristics contribute to agency status and a precise listing is difficult. Yet it is apparent that removal of the entire spectrum of alleged competitive advantages of FCS would cause a loss in agency status. The report therefore begins by looking at the effect of loss in agency status on financial markets, the cost of issuing FCS securities, and ultimately the effect on farmers and consumers.

- Loss of agency status could significantly reduce the marketability of FCS securities, but there is a wide divergence of opinion on the magnitude of the reduction. Bond dealers believe that FCS could issue only \$5-10 billion annually in bonds with over 5 years to maturity compared with a total current annual bond issue of about \$50 billion. This would leave issues of discount notes, 6 month to 5 year bonds and other methods of attracting funds to cover the remaining funding needs.
- As of January 1, 1982, the FCS had \$32.4 billion in securities which matured in 1982. If marketability of FCS securities were significantly reduced by loss of agency status, it could be difficult for FCS to roll over maturing issues.
- Loss of agency status would likely, at a minimum, increase the cost of issuing FCS securities to a cost comparable to high grade corporate bonds--an increase of 50-75 basis points. If problems in accomplishing roll-over occurred, the cost of issuing FCS securities could increase even further, by as much as 2 percentage points, in the opinion of bond dealers.
- If loss of agency status creates a significant loss in market access for FCS securities, credit demand would shift to other lending institutions. However, at least in the short-run, it seems unlikely that commercial banks or life insurance companies could handle a significant share of current FCS lending activity. Credit needs of farmers could go unmet unless government lending agencies fill the gap. Under this scenario significant pressure for expanded government lending programs for agriculture would likely develop.
- Turmoil in financial markets caused by loss of agency status would cause a "flight to quality," i.e., increase the demand for Treasury securities. Initially, this could lower the cost of Treasury issuances, but if government loan programs for agriculture were expanded, the Treasury would likely need to borrow more heavily.
- Loss of agency status would place FCS in the corporate sector to raise funds. While the securities of FCS might initially be classified as AAA (assuming no major problems in roll-over), the rating of such securities would likely reflect more closely the

economic conditions in agriculture. This could cause greater variability in the interest cost of issuing FCS securities than currently exists with agency status.

- In the long run, financial markets would adjust to the elimination of agency status for FCS securities. However, such an adjustment would likely increase interest costs for farmers, thereby reducing agricultural incomes in the short run.

An analysis of specific proposals to eliminate alleged competitive advantages of the Farm Credit System reveals that:

- If the interest income on FCS securities were no longer exempt from State and local income taxes, the cost of issuing securities would need to rise by 50-75 basis points to leave the investor with the same after tax earnings. However, bond dealers estimate that such a change would raise the cost of issuing FCS securities by only 5-10 basis points because many investors are not influenced by such taxes. If such a change were made, State and local revenues would likely increase, but Federal tax revenues would be lowered due to the deductibility of taxes paid to State and local governments.
- If Federal Intermediate Credit Banks' income were taxed and if patronage refunds in the form of stock were taxed to the local PCAs, interest rates paid by PCA borrowers might need to increase by 4-7 percent to maintain the same after-tax growth in equity for FICBs and PCAs. For example, if rates charged PCA borrowers averaged 15 percent with the tax exemption, they might need to increase to 15.6 - 16.05 percent without the exemption. These calculations assume FICBs pay the same effective tax rates as recent average effective rates paid by PCAs. However, taxation would likely increase the use of tax management strategies. Taxation might also lead to a strategy of generating less earnings in FICBs and PCAs and increasing stock purchase requirements to generate equity capital. The net result would still be a rise in the effective rate paid by farm borrowers.
- If the income of Federal Land Banks and Federal Land Bank Associations were taxed, interest rates charged farm borrowers might need to rise by 5-8 percent for the FLBs and FLBAs to maintain the same level of after-tax growth in equity. Thus, if FLB interest rates average 13 percent before taxation, they might need to rise to 13.65 - 14.04 percent after taxation. Again tax management strategies might be used to moderate these increases. However, FLBs appear to have fewer options than FICBs to reduce taxable income.
- Currently, sponsored credit agencies' securities are exempt from the limitation that commercial banks cannot invest more than 10 percent of unimpaired capital and surplus in the obligations of one issuer. If this exemption were removed, about 70 percent of the banks would likely have to restructure their investment portfolio away from agency securities. This would significantly reduce the marketability of agency securities and thereby increase the cost of issuances.

- If FCS securities could not be underwritten by commercial banks, there could be a tremendous loss in marketability of FCS bonds. Banks are a major underwriter of FCS securities. The initial shock of such a change would be significant and would likely raise the cost of issuing FCS securities.
- If FCS securities were required to receive SEC clearance, the cost of issuance could increase slightly and market demand could be reduced because of margin requirements. Overlapping functions between FCA and SEC would need to be eliminated.
- The agency status of the Farm Credit System and other federally sponsored agencies likely reduces the cost of issuing securities and increases the marketability of such securities. However, there are other factors such as strong credit history, strong capital structure, quality of management, and the large size of nationally federated structure of FCS which allows their securities to be sold at rates below those of commercial banks or other corporate issuers of securities.
- The issuances of FCS securities are regulated by the Farm Credit Administration. However, these securities are not rated by bond rating services. If agency status were removed, FCS bonds would likely be rated AAA. Such ratings could add up to 50 basis points to the cost of issuance because of market perceptions that AAA rated bonds may be less secure and do not carry agency status.
- If the Federal Reserve could not purchase or sell FCS securities as a part of open market operations, there would be a minor impact on the cost of issuance because the Federal Reserve purchases have been a small part of total sales. However, the market would likely question why such a change was needed and this could raise the cost of issuing FCS securities. Also, such a change would appear to be capricious since the Federal Reserve can conduct open market operations with a variety of securities.
- Federal Intermediate Credit Banks are eligible to discount agricultural paper with Federal Reserve Banks. Banks, credit unions, and savings and loans also have authority to borrow through the Federal Reserve System, so the FCS does not appear to have a competitive advantage on this point.
- If Federal credit unions were restricted from investing in FCS securities, a potential purchaser would be lost. At times, credit unions have accounted for up to 7 percent of total sales. This would likely raise slightly the cost of issuing FCS securities.
- If FCS securities did not qualify as a short-term liquid investment for savings and loan associations, purchases of these securities by S&Ls would likely decline. As a result, the demand for FCS securities would fall and cost of issuance would rise. Such a change, however, would appear to reduce S&L profitability only slightly.

THE WHITE HOUSE

WASHINGTON

January 14, 1983

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: THE NATIONAL PRODUCTIVITY ADVISORY COMMITTEE

SUBJECT: Cooperative Research and Development

This is the fourteenth in a series of memorandums reporting the recommendations of the National Productivity Advisory Committee for specific actions the Government can take to increase productivity.

Recognizing the key role that cooperative research activities currently play in the international market place and the greatly expanded use of such efforts by some countries, the Committee believes that the United States Government should review its own policies to insure that they do not impede the competitive or cooperative efforts of U.S. ventures. Without adopting interventionist measures, the Federal Government can take additional steps to facilitate cooperative research and development and thereby remove impediments to the productivity growth and international competitiveness of American industry. Accordingly, the Committee has developed recommendations in two areas.

Recommendation #29: The Committee recommends that government and industry jointly review current antitrust laws and practices to identify the need to clarify further existing antitrust policies to cooperative research and development efforts. In addition, it recommends that the Department of Justice revise or expand its Business Review Procedures to permit a continuing dialogue among Justice and corporate officials proposing specific industrial R&D cooperative ventures, especially involving the actual production of products.

Industry spokesmen continually contend that the Government's antitrust policies impose a barrier to cooperative R&D ventures. Department of Justice officials point out that of the twenty-one joint research ventures they have been asked to review in the last twelve years, they have provided an unfavorable response to only two, declined to rule on one, and never have prosecuted where a favorable letter of intent was issued. In addition, the Department issued in 1980 an "Antitrust Guide Concerning Research Joint Ventures" to clarify their position.

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Nevertheless, industry representatives continue to insist that the rules defining legitimate joint R&D ventures are unclear; they claim that the specific antitrust limits of acceptable conduct under cooperative R&D arrangements are vague. Antitrust officials counter that industry has not tested the limits efficiently to elicit appropriate clarification, adding that industry is using antitrust as a scapegoat for its own inaction. Whatever the merit of these conflicting positions, the fact remains that a strong divergence of views exists. Accordingly, the Committee believes that government and business officials should review this issue jointly.

A key question in this area is the extent to which our antitrust laws have remained compatible with the determinants of competition within a much changed international economic environment. Foreign firms now present a formidable challenge in high technology industries, and foreign governments support these industries with a wide variety of measures. Seldom do foreign governments permit their antitrust policy to impede collaborative efforts in high technology sectors identified as essential to the achievement of national economic goals. Many foreign firms, encouraged by their home governments, now define their relevant markets in terms of global markets rather than national markets. In view of this, the Committee believes that a review of our own antitrust laws and practices is necessary to assure that they do not unnecessarily impede collaborative R&D among American companies and to determine whether revision is necessary to foster such efforts.

Recommendation #30: The Committee recommends that the Department of the Treasury develop and publicize tax guidelines concerning the use of Limited Research Partnerships (LRP) for cooperative R&D purposes. The Government should establish a program to provide information to the private sector on the mechanisms for establishing legitimate limited research partnerships, including the tax advantages of such ventures. In addition, the Committee recommends that the Departments of Treasury and Commerce evaluate the experience under the incremental research and development tax credit with a view to developing proposals that would maximize private R&D investments likely to contribute to productivity improvement.

Tax incentives are an important part of creating an environment to stimulate greater private sector funding of research and development. It is not clear what impact all of the tax incentives developed during the last two years will have on

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cooperative research and development ventures, but limited research partnerships potentially may be very attractive under the new tax incentives that offer opportunities for funding cooperative R&D, especially R&D designed to produce specific new products.

Although these partnership ventures have grown significantly over the last two years, there seems to be a general lack of knowledge in how to take advantage of new tax incentives for such ventures. Definitive IRS guidelines on LRP tax revisions are not yet available. The IRS may question some current LRP tax practices, and it is possible that the incentives applicable to legitimate LRP's could be jeopardized. Accordingly, the Committee believes that the Government should act promptly to set guidelines for the use of the new tax revisions by LRP's to assure the continued and legitimate use of LRP's in cooperative research and development funding.

Although there is insufficient data at the present time to appropriately assess the incremental research and development tax credit enacted in the Economic Recovery Tax Act in 1981, the Committee believes that the current credit provisions can be improved in several respects. First, the incremental tax credit is available only for certain expenses paid or incurred during the taxable year in carrying on any trade or business of the taxpayer. The credit would not be available to an entrepreneur who does not have a business or who is currently in another business, even though he may be spending funds on research and development to invent or develop a product or process with the idea of starting up a business to market that product or use that process.

Second, the upper limit placed on an increase in R&D expenditures subject to the credit may significantly limit the availability of the credit for increased R&D expenditures. Therefore, firms may be discouraged from making large increases even when necessary to achieve a critical minimum research effort. Finally, it is not clear that the current credit actually encourages additional R&D expenditures; it may only reward those who would undertake the research anyway.

The Committee does not recommend changing the provisions of the incremental R&D tax credits at this time, however, because it is too early to adequately evaluate them. The Committee believes that the credit can be improved in ways that will maximize private R&D investments more likely to contribute to productivity improvement, and therefore recommends that Commerce and Treasury evaluate the experience under the credit with a view to developing recommended changes.

*Roger B. Porter*  
Roger B. Porter

THE WHITE HOUSE  
WASHINGTON

January 14, 1983

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: THE NATIONAL PRODUCTIVITY ADVISORY COMMITTEE

SUBJECT: Health Care Costs and Productivity

This is the fifteenth in a series of memorandums reporting the recommendations of the National Productivity Advisory Committee for specific actions the government can take to increase productivity.

Expenditures on health care have risen rapidly during the past decade and are now at 10 percent of the Gross National Product; this represents \$1,225 per person. Medicare, and the federal-state cost of Medicaid, increased at an average rate of 16 percent per year between 1975 and 1980, and at a rate of 21 percent in 1981. The total cost for these programs grew from \$30.8 billion in 1975 to \$72.5 billion in 1981. In addition, the medical care component of the consumer price index has been rising faster than all other items in the index. In the period 1980-81 the medical care component rose 12.5 percent compared to 8.9 percent for all other items.

With respect to the composition of health care expenditures, in 1980 thirty percent of personal health care payments were paid out-of-pocket, compared with sixty percent in 1950. Public programs paid 40 percent and private health insurance paid 27 percent of personal health care expenditures in 1980. The largest portion of the health care dollar is spent on hospital care, which was 40 percent of the total in 1980. Physician services accounted for 19 percent and nursing home care for 8.4 percent.

The National Productivity Advisory Committee believes it is critical to limit health care costs, but at the same time maintain the quality of and access to health care. By improving health care productivity, current levels of care can be provided at lower cost. Better care also will improve the quality of our labor force and further improve its productivity.

The Committee recognizes that providing health care is complicated by rapidly rising costs and enormous technological change. In addition, it is an emotional and politically

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sensitive issue. The Committee believes, however, that there is an opportunity to achieve a consensus on reducing health care costs through higher productivity.

Recommendation #31: The Committee recommends that the Federal Government and state governments encourage the development and operation of local and state health care coalitions composed, in varying configurations, of hospitals, physicians, insurers, business, labor, and other community groups to address health care costs and associated questions in local settings.

In the last several years local and state health care coalitions have grown. Currently there are about 120 coalitions at varying stages of development. Many of them have concentrated on constraints on hospital beds, utilization reviews, outpatient and ambulatory care, reviewing benefit structures, and other related issues depending on the problems and opportunities of the particular locality. These coalitions provide an opportunity for systematic dialogue among themselves and with government on how to restrain costs, adjust to lower federal aid, and maintain quality and access of health care benefits.

Recommendation #32: The Committee recommends providing federal assistance to health care coalitions and the leaders of health care provider associations, insurers, business and labor organizations to develop guidelines of acceptable cooperative efforts to constrain health care costs. The government should assist in reducing uncertainty about the antitrust laws that would apply to coalition activities designed to constrain health care costs through sharing information on utilization, constraining new hospital bed construction where the supply is already excessive, and in providing alternative health care services.

The Committee is not suggesting changing the antitrust laws to permit cartelization of health care services, but rather that health care coalitions and others concerned about constraining cost increases of health services understand what they can do without violating the antitrust laws. If community groups decide, for example, as they did in Cincinnati, that there are too many hospital beds in their community, then subsequent efforts to reduce the expansion of beds will have a positive impact on reducing costs later on. If a coalition determines

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that there are not enough ambulatory care facilities and subsequently more are provided, this too can result in constraining health care expenditures. Many business organizations engaged in these activities, however, have been concerned about the limits of permissible activity, albeit designed to reduce cost, and the Committee believes the government should clarify what is permissible and what is not.

Recommendation #33: The Committee recommends replacing cost reimbursement for institutional care with prospective reimbursement, with the health institution sharing gains and losses from the prospective budgeting. The Government should adopt these procedures for medicare and should also encourage the general adoption of such prospective budgeting.

The Congress mandated that the Department of Health and Human Services produce by December 31, 1982, a prospective budgeting system for certain health care expenditure categories. It believes there are great opportunities for cost and productivity savings in this area. The Committee recognizes there will be problems requiring special attention in how prospective budgeting is applied to hospitals attached to medical centers and in accounting for regional cost differentials, patient load, and other unanticipated factors. But the Committee believes that these administrative problems are manageable.

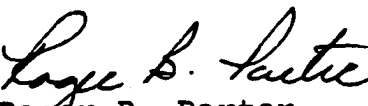
Recommendation #34: The Committee recommends further experimentation, in collective bargaining or in administrative practices, with devices that encourage choices among workers and groups of workers as to health care benefits--so called cafeteria plans where workers receive directly funds not expended on health care. The Government should not mandate specific details but should provide appropriate assistance in helping organizations develop these opportunities and in appraising the results of these experiences.

The Committee believes that there may be some minimum benefit level that will need to be prescribed, beyond which employees would be able to select the health benefit they prefer. Because adverse selection problems likely will arise, the Committee believes that the government should support follow-up evaluation systems.

The Committee recognizes that these recommendations are modest, and it has discussed additional alternative proposals.

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It believes that these four recommendations can provide an opportunity to build consensus in this area and at the same time assure progress in reducing health care expenditures by improving the productivity of the health care delivery system.

  
Roger B. Porter  
Executive Secretary